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 Petition of Bay State Gas Company, pursuant to G.L.)
 c.164, § 94 and 220 C.M.R. § 6.00 *et. seq.*,) D.T.E. 01-81
 for authority to establish Gas Cost Incentive Mechanism)
 _____)

The Attorney General, pursuant to 220 C.M.R. § 1.11(7), hereby moves the Department of Telecommunications and Energy (“Department”) to reopen the record to admit post-hearing evidence relating to price-fixing or gaming in the natural gas market. As grounds for this motion, the Attorney General states that good cause exists to admit the post-hearing evidence because new evidence recently became available on the issue of price fixing and gaming in the natural gas market and this new evidence has material bearing upon this case.

On June 19 and 20,¹ the Department held evidentiary hearings regarding the petition (“Petition”) filed by Bay State Gas Company (“Bay State” or the “Company”), in which the Company seeks the Department’s authorization and approval to establish a Gas Cost Incentive Mechanism (“GCIM”). During the evidentiary hearings, the Department asked the Attorney General’s expert witness, Mr Timothy Newhard, about the ability of individuals or companies to affect market indices. Tr., p. 277. The Department also issued a record request on the issue requesting that the Attorney

¹ Evidentiary hearings commenced on May 6, 2002, but were suspended until June 19, 2002.

General provide evidence to support his claim that individuals are able to affect market indices. *See* RR-DTE-6. On July 3, 2002, Attorney General responded to the Department's record request. On July 23, the Attorney General reiterated his concerns regarding the possibility of price manipulation in the natural gas market under the Company's GCIM proposal. AG Reply Brief, p. 2.² Following the submission of briefs by all the parties, new evidence surfaced on the ability of individuals or companies to affect market indices.

II. STANDARD OF REVIEW

The Department may, for good cause shown, allow parties to file evidentiary documents of any kind, or exhibits, at a time subsequent to the completion of hearing. *See* 220 C.M.R. 1.11 (7). Good cause has been defined as a showing that the proponent has previously unknown or undisclosed information regarding a material issue that would be likely to have a significant impact on the decision. *Blackstone Gas Company*, D.T.E. 01-50, at 14 (2001) *citing Machise v. New England Telephone and Telegraph Company*, D.P.U. 87-AD-12-B, at 4-7 (1990); *Boston Gas Company*, D.P.U. 88-67 (Phase II), at 7 (1989); *Tennessee Gas Pipeline Company*, D.P.U. 85-207-A, at 11-12 (1986).

III. ARGUMENT

A. Good Cause Exists To Reopen The Record To Admit Post-Hearing Evidence.

The evidence that the Attorney General seeks to admit into the record is evidence that became

² The Attorney General first voiced his concerns on price manipulation and gaming through the testimony of Mr. Timothy Newhard, which was filed with the Department on April 5, 2002. *See* Exh. AG-1, pp. 12-15.

available after the close of hearings and after all parties had submitted their briefs. The Attorney General seeks to admit two documents into the record. The first document is a newspaper article entitled *Natural Gas Prices Thrown in Doubt*. *Wall Street Journal*, November 12, 2002. The second document is a Staff Report prepared by the Federal Energy Regulatory Commission (“FERC”) in August 2002 which is entitled *Initial Report On Company-Specific Separate Proceedings And Generic Reevaluations; Published Natural Gas Price Data; And Enron Trading Strategies – Fact-Finding Investigation Of Potential Manipulation Of Electric And Natural Gas Prices*, and was issued in connection with FERC’s investigation in Docket Number PA02-2-000. Both documents are attached hereto as Attachment 1 and Attachment 2. The Attorney General believes both documents could have a material impact on the Department’s decision in this case since they provide important new evidence on an issue that received substantial attention throughout the course of these proceedings. *See e.g.*, Exh. AG-1, pp. 12-15; Co. Initial Brief, p. 22, AG Reply Brief, p. 2; RR-DTE-6; Tr., pp. 277.

The Company proposed the use of gas price indices as the basis for the sharing formula in its GCIM proposal. The use and the reliability of gas price indices were a contested issue during the proceedings. FERC’s Staff Report which is proposed as Exhibit AG-4 and is provided as Attachment 2 to this motion states the following:

- (1) Staff is troubled by the lack of reported formal verification or corroboration that the reported firms state they performed. This opens the door for entities to deliberately misreport information in order to manipulate prices and/or volumes for both electricity and natural gas. In the absence of some form of double-checking, such misreporting is likely to be undetected in the reporting process and uncorrected when prices are published. *Staff Report*, p. 48.

- (2) Certainly, there is a significant incentive on the part of certain market participants to deliberately misreport prices, given that natural gas is the fuel input for the electricity generators that set the market price in California and the rest of the West. Unscrupulous traders could manipulate natural gas price indexes in order to increase the profitability of their electricity positions. The means by which this misreporting could occur is actually quite simple. Traders overstate prices to the reporting firms, which in turn publish price data that incorporate the overstated prices. Buyers and sellers themselves cannot verify those prices because different reporting firms report information differently, *e.g.*, end-of-day vs. average, trades vs. bid/ask postings. However, the natural tendency is for buyers and sellers to assume that the published prices are accurate, so an overstated published index may then affect the actual price buyers pay for transactions. Thus, misreported prices could become part of the price formation process and adversely affect the true market price. *Staff Report*, pp. 48-49.
- (3) At this point in time, the Commission cannot validate published price data. This is due, in part, to the reporting firms' status as non-jurisdictional entities as well as their legitimate desire to protect the confidentiality of their sources. Without knowing the source of the raw data, there cannot be any independent validation of the price data published by any reporting firm. *Staff Report*, p. 49.
- (4) For the purposes of this initial report, we focus on the question of whether wash trading can be used to manipulate price data or otherwise adversely affects the accuracy of published price data. Staff believes that wash trading can adversely affect the accuracy of published price data under certain circumstances. For example, wash trading provides the illusion of a deep market (that is, more volume than absent wash trades), which may lead buyers to assume they are getting a competitive price and trading in a liquid market when in fact they are not. Another problem is that, because the daily closing price is often based on the last trade, a wash trade at the end of a trading day could be used to deliberately move that price. In fact, Platts indicated that its forward price data is meant to mirror the end-of-day price used in mark-to-market accounting. In a thinly-traded market, *e.g.*, forward markets, one wash trade could move the market price. *Staff Report*, p. 55.
- (5) Because there is no way to validate the data given to the reporting firms, the possibility of a detrimental effect on prices cannot be discounted. Staff will continue to assess the role that wash trades play on the prices for natural gas and electricity. *Staff Report*, p. 55.
- (6) In addition to the characteristics and problems in published price data discussed above, none of which is specific to California, Staff has reason to conclude that the reporting of natural gas prices in California has its specific, additional problems. First, there are

numerous delivery points into Southern California, and, at least in part due to the regulatory structure of the California natural gas market, prices can be significantly different at the various delivery points. *Staff Report*, p. 56.

- (7) Second, firms have incentives to overstate the price they pay for natural gas in order to affect the index price. These incentives include: (a) a higher index price will reduce their refund exposure for electricity (increased natural gas prices raise the market-clearing price); and (b) a higher index price will allow them to benefit from state-level performance-rate incentives.³ *Staff Report*, p. 56.
- (8) Having numerous entities with incentives to move the price in one direction makes price data particularly susceptible to manipulation. In addition, the number of trades at the specific points can be small at a given time, making them particularly vulnerable to influence by a few entities. *Staff Report*, p. 57.

The *Wall Street Journal* of November 12, 2002, page C-1 which is proposed as Exhibit AG-5 and is provided as Attachment 1 to this motion, reported on the reliability of the gas price indices and gas price manipulation.

IV. CONCLUSION

For the reasons discussed above, and for good cause shown, the Department should grant the Attorney General's motion and reopen the record to allow his post-hearing evidence.

RESPECTFULLY SUBMITTED,

THOMAS REILLY
ATTORNEY GENERAL

By:

³ Each of California's three large natural gas local distribution companies has a gas cost incentive mechanism, under which it profits if it buys gas at prices lower than its reference benchmark price. While each company's benchmark reference is formulated differently, in all cases, California border prices are a key part of the benchmark. Therefore, higher reported prices drive up the benchmark and therefore benefit those companies. In addition, payments to gas-fired qualifying facilities in California are based on the reported Topock price, giving another large group of gas purchasers in California a reason to benefit from higher reported natural gas prices.

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